

**RELATIONSHIP QUALITY IN FRANCHISING : ANTECEDENTS AND  
OUTCOMES**

**by**

**KHAIROL ANUAR BIN ISHAK**

**Thesis submitted in fulfillment of the requirements  
for the degree of  
Doctor of Philosophy**

**July 2015**

## **DEDICATION**

**Dedicated to my wonderful parents, Hajjah Puteh binti Dahman and  
Ishak bin Hashim, my lovely wife Nurul Afzan Azizan  
and my children Muhammad Syahmi, Luqman Hakim, Arif Naufal  
and Amna Safiyyah.**

## ACKNOWLEDGEMENTS



First and foremost, my sincere gratitude goes to Allah, The Most Gracious, The Most Merciful. Praise be upon his prophet Muhammad (SAW).

The PhD journey has been one of the toughest in my life. The process of preparing this dissertation is really challenging and needed my full commitment in order to complete my writing to the final chapter. The completion of this thesis would not have become a reality without the invaluable support, sacrifice, encouragement, and inspiration of several individuals and organisations. Hence, I wish to acknowledge my appreciation to all those who have extended their support in many different ways. I would firstly like to thank my supervisor Professor Dato' Muhamad Jantan for his valuable guidance and support during this journey. I am deeply indebted, as his constructive criticisms helped clear the cobwebs and kept me constantly focussed. I was very fortunate to be under his supervision, as he embraced every responsibility of a principal supervisor to guide my research. I also record my gratitude for intellectual support of Prof T. Ramayah, who provided me with valuable assistance, especially in structural equation modelling (SEM), Puan Sharifah Suraya Alhabshi and Encik Mohamad Azahar Mahmood who provided good administrative support especially in arranging the schedule for meetings. I am indebted to the Center of Policy Research and International Studies (CENPRIS), Universiti Sains Malaysia for their kind assistance and support, especially in giving me valuable comments for my findings chapter. My grateful thanks also go to the University Utara Malaysia for financing the scholarship to pursue my PhD study.

The critical aspect of my journey was during data collection. I am extremely grateful to Encik Ahmad Faizal Mohamed Noor from Malaysian Franchise Association (MFA), Encik Ismainur Hadi Amat Bakeron from the Ministry of International Trade, Consumerism and Cooperatives and Dato' Syed Kamarulzaman bin Dato' Syed Zainol Khodki Shahabudin from PNS who granted assistance and provided

letters to support my data collection among franchisees in Malaysia. I also thank Encik Abdul Malik Abdullah from MFA who offered assistance to meet with top franchisors within the MFA membership. I am very grateful to all participant franchisors who willingly shared their franchisee information during the data collection process. All the other respondents who I am unable to mention here also deserve recognition for sacrificing their time in completing the survey questions.

Finally, and most importantly, I wish to thank all those whose love and assistance to have helped to lighten the burden of pursuing a PhD. To my mother for her unconditional love, care and prayers; to my father for his encouragement; to my brothers, sisters, in-laws and uncles who were particularly very supportive; to my wife Nurul Afzan Azizan for her blessing; and to my children, Muhammad Syahmi, Luqman Hakim, Arif Naufal and Amna Safiyyah and also the subject matter researched upon. Without assistance from God I would not be able to reach the end of my journey. I learn a lot in managing relationships between people-people and people-God. This PhD Journey enabled me to believe in my compelling desire to break away from all obstacles in my life and think positively to seek success in the future as an academician.

***Khairul Anuar Ishak***

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## **LIST OF ABBREVIATIONS**

AMOS	Analysis of Moment Structure
ANOVA	One way Analysis of variance
AVE	Average Variance Extracted
B2B	Business-to-business
CB-SEM	Covariance-based Structural Equation Modeling
CFA	Confirmatory Factor Analysis
CR	Composite Reliability
CR	Critical Ratio
CSV	Comma-Separated Values
EFA	Exploratory Factor Analysis
EU	Environmental Uncertainty (Competitive Intensity)
FDP	Franchise Development Program
FP	Financial Performance
GDP	Gross Domestic Product
GOF	Goodness-of-Fit
LV	Latent variables
MDTCC	Ministry of Domestic Trade, Cooperative and Consumerism
MECD	Ministry of Entrepreneurship Development
MFA	Malaysia Franchise Association
MV	Manifest variables
MV	market Volatility
NFDB	National Franchise Development Blueprint
NFP	Relationship Performance
PERVAL	Perceived Value
PLS	Partial Least Square
PLS-SEM	Partial Least Square Structural Equation Modelling
PNS	Perbadanan Nasional Berhad
RM	Relationship Marketing
RN	Relational Norms
ROA	Return on Assets
ROF	Registrar of Franchise
ROI	Return on Investment
RQ	Relationship quality
RV	Relationship Value
SD	Standard Deviation
SE	Standard Error
SEM	Structural Equation Modelling
SET	Social Exchange Theory
SPSS	Statistical Package for Social Science
TCA	Transaction Cost Analysis
TSI	Transaction Specific Investment (relationship investment)

## LIST OF PUBLICATIONS

### Conference Paper

Ishak, K. A. (2010). Franchising in Malaysia : Issues and research agenda. *In International Conference on Public Policies & Social Sciences (pp. 1–12)*. Sungai Petani, Kedah.

Ishak, K. A. & Jantan, M. (2010). The Franchising Relationship Quality: It is important? *In International Conference on Marketing*. Kuala Lumpur, Malaysia.

Ishak, K. A. & Jantan, M. (2013). The Relationship Quality in Franchise Networks: Is it important to performance? *In 10th AAM International Conference 2013*. Penang, Malaysia.



## **KUALITI PERHUBUNGAN DI DALAM FRANCAIS:**

### **ANTESEDEN DAN KESANNYA.**

#### **ABSTRAK**

Kajian ini cuba merungkai secara empirik kepada dua konstruk yang telah dikenalpasti iaitu mekanisme perhubungan dan mekanisme transaksi yang mungkin mempengaruhi kualiti perhubungan. Selain itu, kajian ini juga mengenalpasti dua impak utama kualiti perhubungan iaitu prestasi dan kesetiaan pihak francais. Kajian ini adalah berbentuk kuantitatif dan menggunakan kaedah kajian keratan rentas. Tiga belas syarikat francais sahaja yang bersetuju untuk menyertai kajian tersebut dan seratus dua puluh lapan jumlah borang soalselidik yang berjaya diperolehi daripada francais melalui keadah pos dan maya untuk dianalisa. Secara khususnya, kajian ini mendedahkan bahawa hanya mekanisme perhubungan berbanding mekanisme transaksi mempengaruhi kualiti perhubungan di kalangan francais. Kajian ini juga mengenalpasti kepentingan kualiti perhubungan francais terhadap prestasi francais dan kesetiaan francais. Menariknya, mekanisme transaksi telah dikenalpasti menjadi faktor untuk mempengaruhi mekanisme perhubungan dan ianya dilihat memberi kesan secara tidak langsung kepada kualiti perhubungan. Faktor ketidak stabilan persekitaran tidak menyederhanakan hubungan di antara kualiti perhubungan dan prestasi syarikat. Kajian ini juga dilihat dapat memberi implikasi terhadap pengamal francais secara umumnya, dan francaisor secara khususnya, bagi mengendalikan faktor-faktor penyumbang kepada kualiti perhubungan, prestasi perniagaan dan kesetiaan francais supaya mereka dapat bersaing dengan lebih kompetitif lagi di samping dapat menjana lebih keuntungan bagi jangka masa yang panjang.

# **RELATIONSHIP QUALITY IN FRANCHISING: ANTECEDENTS AND OUTCOMES.**

## **ABSTRACT**

This study attempts to examine empirically two constructs namely relational mechanisms and transactional mechanisms which may influence the relationship quality in franchising relationship. Furthermore, this study examines two main outcomes of relationship quality namely performance and loyalty in franchising relationships. This study adopts a quantitative approach, applying a cross-sectional study. Thirteen franchisors were willing to participate in the survey, and one hundred and twenty eight useable questionnaires were received from mail and online survey from franchisees. The findings reveal that relational mechanisms but not transactional mechanisms are crucial in affecting franchisee relationship quality. The results provide strong evidence that franchisee relationship quality is found to significantly affect business performance and franchisees' loyalty to stay in the franchise system. Interestingly, transactional mechanisms are identified as antecedents of relational mechanisms indirectly influencing relationship quality in franchise relationship. In addition, this study reveals that environmental factors do not moderate the relationship between relationship quality and business performance. The inclusion of relationship value is suggested to contribute additionally to the literature of relationship marketing relationship and provide a more complete model within the franchising context. Findings also imply the need for franchise players in general, and franchisors in particular, to strategically handle the key antecedents of relationship quality, business performance and loyalty in pursuit of a more competitive and long term profit.

# **CHAPTER ONE**

## **1.0 INTRODUCTION**

### **1.1 Introduction**

There has been a major shift in ensuring the existence of an organization in its business life-cycle, especially in open markets. Paradigm shifts in business organization are needed in order for businesses to improve their market share and expand into new ventures. Firms have options to develop new business models such as franchising and licensing; these can be imitated and work in diverse economic systems and different geographical areas. Nevertheless, franchising is found to be the best option to enter for a new market either local or international markets (Quinn & Doherty, 2000). Frank and Stanworth (2003) argue that franchising is becoming more important in generating national economies and has attracted the interest of scholars, researchers, journalists, politicians, etc. in exploring the uniqueness of the franchise system. Furthermore, franchising allows for rapid and effective market penetration using franchisee resources such as financial capital, managerial talents and local market knowledge (Stanworth & Curran, 1999). For example, the US Sewing Machine Company, Singer, has successfully used franchising of its business by appointing enterprises to distribute its products and provide continuing customer support throughout the US market (Stanworth & Curran, 1999). The franchise model has proven to be an effective business model. McDonald, one of the largest franchised fast-food restaurants in the world was established in 1955 and successfully ventured into over 119 countries across 35,000 outlets (McDonald, 2007). Others chains such as Hertz Rent-A-Car, A&W Restaurants, Holiday Inns,

Burger King, Dunkin' Donuts, Pizza Hut, Subway, KFC and Kenny Rogers Roasters also use franchise systems (Blair & Lafontaine, 2005).

Franchising is a way of expanding a business in the global environment. Franchising has been at the leading edge of business since the 1950s by showing incredible growth rates in sales. During economic recession, franchising survives by reducing operations costs and increasing unit sales (Justis & Judd, 2003). Franchise systems are replications of a franchisor business model which has proven to be successful in providing quality and uniformity of products/services. Compared with conventional business, franchise systems are strategic alliances between franchisors and franchisees with both parties having a principal and agency relationship.

Franchising is a contractual agreement between two parties (franchisor and franchisee) in which the franchisee pays the franchisor for the right to sell products or services and/or the right to use trademarks and business formats in a given location for a specified period of time (Blair & Lafontaine, 2005). In franchising, the franchisor, being the owner of business, grants exclusive rights to the franchisee for local distribution and sale of products or services using its trademark, business operational procedures and marketing plans.

The first formal form of franchising in consumer goods was in the year 1850, when McCormick Harvesting Machine Company granted the "exclusive local agents" to independent salesmen to sell and service its sewing machines in the US (Justis & Judd, 2003). McCormick later formed Singer Sewing Machine Company which was considered as the first example of a franchise-oriented system to distribute and sell products. As a result, McCormick was able to systematize procedures and communications with its agents throughout the US and Canada (Blair & Lafontaine,

2005). Franchising has also been applied intensively in the automotive industry from the late 1800s; General Motors Corporation and Ford appointed their respective authorized dealers to sell and service their customers effectively and efficiently in appointed territories (Justis & Judd, 2003; Khan, 1999). Franchising continued to achieve high levels of performance in the 1950s and 1960s with expansion into convenience products and services (Seid, 2006). Many franchisor companies have successfully used franchise systems to grow rapidly in markets since the 1900s. Examples include Kentucky Fried Chicken (KFC), established in 1930; Dairy Queen, established in 1940; Dunkin Donut, established in 1950; Burger King, established in 1955 and McDonald established in 1955 (Seid, 2006). By that time, the enforcement of trademark and service marks (Trademark Act, 1946) were implemented in the franchise industry. Many prospective entrepreneurs became more confident in franchise business following standard trademarks.

Franchising has become the dominant force in the distribution of goods and services in the United States and in many parts of the world (Khan, 1999). Franchising industries are growing rapidly in most countries and have contributed to the growth of gross domestic product (GDP). In the US, there are approximately 700,000 franchised businesses with approximately \$1 trillion in annual sales amounting to 17% of the country's GDP (Justis & Judd, 2003). According to The Economic Impact of Franchised Business Report, a study conducted by PricewaterhouseCoopers reported that franchising industries contributed US\$2.3 trillion to the US economy, providing representing 11 million direct employments and over 11% of the nation's private sector economy (IFA, 2005). The report also highlighted that franchising industries in the US expanded by 18% from 2001 to

2005, adding more than 140,000 new establishments, and creating more than 1.2 million new jobs. In the UK, the franchise business system increased from 170 in 1984 to 677 in 2002, accounting for US\$1.4 billion to US\$15.2 billion in sales (NatWest, 2000). In conclusion, franchising business has contributed greatly in the creation of employment and continues to be a significant force in a country's economy.

**Table 1-1: Indirect and Direct Impact of franchise business to the US economy**

	Because of Franchised Businesses (indirect)	Percent of the Private Sector Economy (indirect)	In Franchised Businesses (direct)	Percent of the Private Sector Economy (direct)												
<b>Jobs</b>	20,974,636	15.3%	11,029,206	8.1%												
<b>Payroll</b>	\$660.9 billion	12.5%	\$278.6 billion	5.3%												
<b>Output</b>	\$2.3 trillion	11.4%	\$880.9 billion	4.4%												
<b>Direct Employment by Economic Sector:</b>																
<table><tr><th><b>Economic Sector</b></th><th><b>Jobs</b></th></tr><tr><td><b>Franchised Businesses</b></td><td><b>11,029,000</b></td></tr><tr><td>Durable Goods Manufacturing</td><td>8,955,000</td></tr><tr><td>Financial Activities</td><td>8,153,000</td></tr><tr><td>Construction</td><td>7,336,000</td></tr><tr><td>Information</td><td>3,061,000</td></tr></table>					<b>Economic Sector</b>	<b>Jobs</b>	<b>Franchised Businesses</b>	<b>11,029,000</b>	Durable Goods Manufacturing	8,955,000	Financial Activities	8,153,000	Construction	7,336,000	Information	3,061,000
<b>Economic Sector</b>	<b>Jobs</b>															
<b>Franchised Businesses</b>	<b>11,029,000</b>															
Durable Goods Manufacturing	8,955,000															
Financial Activities	8,153,000															
Construction	7,336,000															
Information	3,061,000															

Note on the data: All data are from 2005, the most recent year available. The "direct" contribution comes from the franchised businesses themselves. The "indirect" contribution reflects the additional jobs, payroll, and output franchised businesses created such as food suppliers to restaurants

Source: IFA Educational Foundation, Economic Impact of Franchised Businesses, Volume 2, a study conducted by PricewaterhouseCoopers ("PWC"), p.16.

Today, franchising is becoming more popular in expanding business operations for local and the overseas markets. Franchising has become a successful business model in that it replicates the business format to other businesses. Franchising is considered

as an alternative to become an entrepreneur for starting a new business with a proven business format and less risk of failure. Franchising has been applied in various products and services from food and beverages to pharmacy, hotel services, learning centers, nurseries, health and beauty care, pest control, travel agents, laundry, convenience shops, etc. In addition, the franchisor will use franchising to raise their business capital by collecting franchise and loyalty fees from franchisees. Overall, franchising has benefited the franchisors and franchisees by helping each other in developing the successful business model in future.

In Malaysia, the government has implemented many programs and activities in order to cultivate more franchisors and franchisees to be involved in the franchise business. According to Yusof (2009), the Franchise Development Division under the Ministry of Domestic Trade, Cooperatives and Consumerism plans and implements franchise development policies, initiatives and programs in order to promote franchise development in Malaysia. Furthermore he stated that, the primary government agency, led by Permodalan Nasional Berhad (PNS), plays an important role in developing strategies and implementing many programs to develop successful franchisees and franchisors in Malaysia. The strong support from the Malaysian government in cultivating franchising has produced popular local home-grown franchisors such as Marrybrown, Secret Recipe, Nelson's, D'Tandoor and Smart Reader Worldwide. They have successfully expanded businesses locally and internationally. Franchising has and continues to contribute to Malaysia's economy by generating and replicating successful businesses to a franchise-oriented system.

The government has also recently launched the National Franchise Development Blueprint (NFDB) consisting of a nine year planning period starting in 2012 until 2020 (Raja Adam, 2012). The NFDB has been developed by the Ministry of Domestic Trade, Cooperatives and Consumerism as a milestone which consists of three majors phases of implementation in order to make Malaysia a leading franchise hub in the South East Asia region (MDTCC, 2012a). The three phases are as follows:

- i. Phase 1: from 2012 to 2014 (three years), involves strengthening the franchise player/industry and the franchise development framework;
- ii. Phase 2: from 2015 to 2016 (two years), involves working towards a vibrant and robust domestic franchise industry;
- iii. Phase 3: from 2017 to 2020 (four years), involves creating Malaysia as a Franchise Hub in the South East Asia region and Middle East countries.

The Ministry has revealed four main Strategic Thrusts with 36 strategies supported by 140 programs in order to position Malaysia as the franchise hub for the South East Asia and the Middle East markets. The four main strategic thrusts are as follows:

- i) To enhance competitiveness of Malaysian franchising,
- ii) To transform Malaysia business through franchising,
- iii) To develop competent franchise human capital, and
- iv) To establish a dynamic franchise ecosystem.

This blueprint shows a high commitment by Malaysia's government to ensure the franchise industry will continue to contribute towards the national economic development agenda and creation of a high income society.

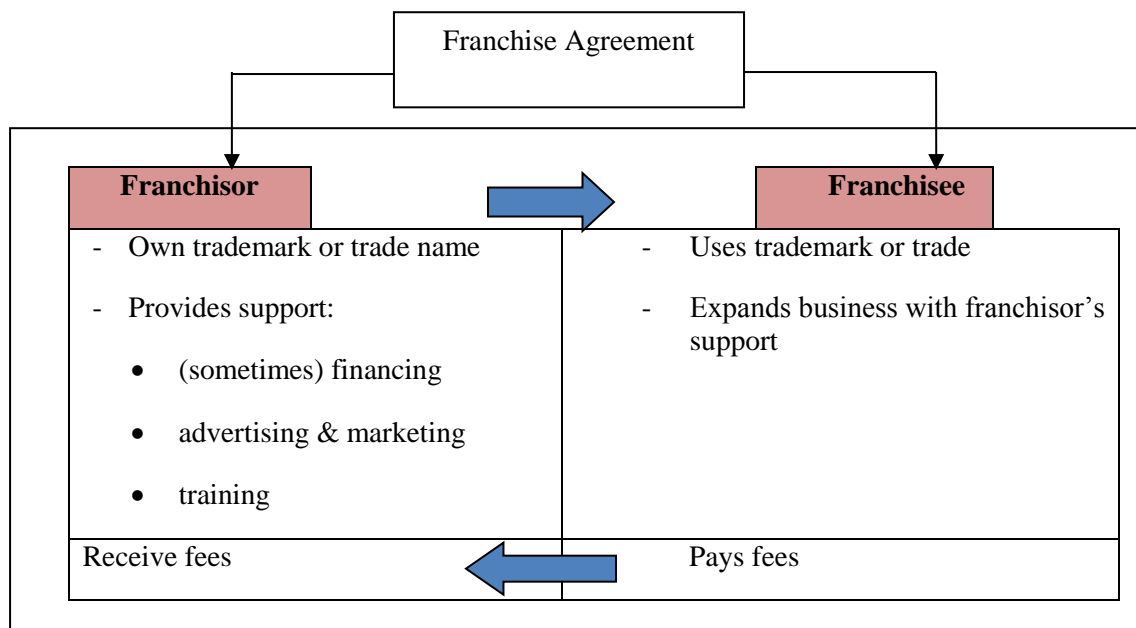


## 1.2 Background of the Study

The term franchising was initially used to refer to a variety of business activities; however, contemporary franchise system refers to business format franchising. Grant (1985) defined business format franchising as follow:

“The granting of a license for a predetermined financial return by a franchising company (the franchisor) to its franchisees, entitling them to make use of a complete business package, including training, support and the corporate name, thus enabling them to operate their own businesses to match exactly the same standards and format as the other units in the franchised chain”. (p.4)

The relationship between franchisor and franchisee is considered a mutually beneficial business arrangement (Bradach, 1998). Franchising has also been classified as a form of strategic alliance (Frank & Stanworth, 2003; Young, Gilbert, & McIntyre, 1996) that is characterized by a formal franchise contract that details the rights and obligations of both parties. The contract guides the franchisee in operating the business operation/system (such as operating hour, menu, training, financial obligations, etc.) and creates a framework for their relationship. The relationship between franchisor and franchisee are interdependent and both parties need to cooperate in order to achieve their respective objectives.



**Figure 1-1 : The relationship of franchisor and franchisee**

Source: Beshel, 2001, p.1

The franchisor-franchisee relationship is complex, requiring the intricate delineation and integration of individual roles for both franchisor and franchisee (Kaufmann & Dant, 1998). This complexity can be potentially hazardous (Davies, Lassar, Manolis, Prince, & Winsor, 2011) leading to conflicts between the franchisors and franchisees regarding priorities, timing and revenue stream (Garg & Rasheed, 2006). This stems from the dissimilarities between franchisor and franchisee in operating the franchise business. For example, a franchisee had taken legal action against Burger King (franchisor) over the \$1 double cheeseburger promotion. The restaurant owners contend that the offer, which was launched in October 2009, forces them to sell the product at a loss (Heher, 2009). As a result, the franchisees may have their contract terminated and lose their investment due to non-compliance by the franchisor. Thus, Khan (1999) suggests that the success of franchisor-franchisee relationship rests on

the mutual understanding of each other and the quality of this relationship is critical for success.

Relationship quality (RQ) has become an important issue in ensuring continuity of any partnership especially in franchising. Studies have highlighted the importance of quality, in particular the quality of relationships from the perspective of business-to-business; for example, seller-buyer relationship (Crosby, Evans, & Cowles, 1990; Parsons, 2002), supplier-dealer (Morgan & Hunt, 1994; Skinner, Gassenheimer, & Kelley, 1992), manufacturer-distributor (Anderson & Narus, 1990; Dwyer, Schurr, & Oh, 1987), importer-exporter (Skarmeas & Robson, 2008) and franchisor-franchisee (Bordonaba-Juste & Polo-Redondo, 2008b; Dickey, McKnight, & George, 2007). Research in relationship quality has shown that companies are putting greater efforts into developing long-term relationships with their stakeholders such as customers, suppliers, strategic partnerships, employees and competitors. This goes to show the importance of relationships quality in business-to-business context.

The franchisor-franchisee relationship quality is considered important in ensuring franchise success. The study by Clarkin & Rosa (2005) shows that a franchised firm will perform well in conditions where there is partnership, collaboration and cooperation between franchisors and franchisees. A franchise system needs a unique symbiotic relationship between both parties (franchisee and franchisor) and they are mutually dependent (Khan, 1999). Justis and Judd (2003) highlight that the franchisor and franchisees need to understand their different roles in a franchise system and the importance of cooperation and mutual trust in their relationship to maintain a successful franchise business. The franchisee and franchisor are equally

important and both parties need to learn to work together in order to achieve success in a franchise system (Justis & Judd, 2003).

Mendelsohn (2004) equates the franchisee-franchisor relationship to a mother-child relationship in the context of the high level of dependence of franchisee to franchisor at the initial stages, lessening its dependencies over time before maturing in the franchise business system. Hunt (1972) identifies the following characteristics of a franchise relationship:

- i. A contract exists which delineates the responsibilities and obligation of both parties,
- ii. A strong continuing cooperative relationship, and
- iii. A franchisee operates the business substantially under the trade name and marketing plan of franchisor. (p.33)

The above characteristics highlight that a franchise is an interdependent organization needing close cooperation and commitment in order to achieve the set-up goals and objectives. Indeed, Shane and Frank (1996) highlight franchising as a gateway to cooperative entrepreneurship, the success of which depends on cooperation between the franchisee and the franchisor.

Franchising is a contractual form of business that grants the right of brand name, copyright or trademark and operating system from franchisor to franchisee (Shane & Frank, 1996). Both parties, franchisee and franchisor, are legally bound by the franchise contract (franchise agreement) in operating the business. The franchise contract becomes an important document to structure the relationship and institutionalize the rules of the franchise business system by explaining the rights, obligations, and responsibilities of both parties (franchisor and franchisee). Furthermore, the franchise contract also protects the financial interests of both parties

(Castrogiovanni & Justis, 1998; Dnes, 1993). The franchisees are required to comply with the entire core business system developed by franchisor in their day-to-day operation, covering all aspects of the business including operating procedures, quality of products/services, and physical appearance of the business facility (Khan, 1999) . This is the main difference with other business-to-business relationships such as supplier-manufacturer, buyer-seller and dealer-manufacturer relationships.

The success of the franchise system depends on a harmonious franchisor and franchisee relationship (Morrison, 1997), because both parties are interdependent in operating the franchise business. Franchisors are expected to transfer their knowledge to franchisees in all aspects of operating the business such as product/service, pricing, operations, standard operations procedures, marketing plan, etc. The franchisee will, thus, have advantages over conventional businesses because they are using the established franchisor's trademark and a proven business system. In return, the franchisor will gain financial rewards by receiving loyalty fees or management fees paid by franchisees for their continued support. Thus, franchises have become efficient capital, managerial and information resources for in collaborations with franchisors (Watson, Stanworth, Healeas, Purdy, & Stanworth, 2005) .

In their study, Dickey et al. (2007) highlight that the quality of franchisee relationship tends to affect overall franchisor performance. This is supported by their finding that franchisees with high unit growth will have high value for relational quality compared with those with low unit growth. In conclusion, this result provides some evidence that the quality of franchisee relationship tends to affect overall

franchisor performance. In order to respond to the quality of relationship issue, this study will investigate the link between relationship quality to firm performance.

Based on the above discussions, the issue of relationship quality is identified as a major factor in determining the strength and quality of the relationship between franchisee and franchisor. Indeed, Nathan (2007) argues that the franchisee and franchisor are in the customer services business and the relationship business. Even though this relationship is recognized by many researchers as important and critical in a franchise system, little attention has been given to this issue, especially from a franchisee perspective (Davies et al., 2011). As such, this study will investigate the factors that contribute to an effective franchisor-franchisee RQ and examine the main effects of RQ towards performance and loyalty to stay in this franchise system.

### **1.3 Franchising in Malaysia**

Franchising started in Malaysia with the introduction of the Singer sewing machine in 1948. Singer became the first company in Malaysia to distribute sewing machines and home electrical appliances by using a product and trade name franchising format. In the initial stage, Singer appointed authorized sales agent (dealer) to distribute their products across various states in Malaysia. Similarly, other companies such as Bata shoes outlets, car/motorcycle dealers, petrol stations and soft drink production also started using product and trade name franchising format to market and distribute their products. With regard to fast-food restaurant chains, in 1967 A&W became a pioneer in franchise restaurants. After the 1990s, the franchise industry successfully started to develop in Malaysia.

Franchising in Malaysia is still in its infancy and the growth only began in 1992 when the government started to promote franchising systems through educational and awareness programs such as seminars, workshops, expositions and exhibitions throughout Malaysia (Aziz, 1999). At the early stages of the introduction of franchise business in Malaysia, only a few franchise businesses operated in Malaysia such as Singer, Bata, petrol stations and car dealerships. The Franchise Development Program (FDP) in 1992 was established and administered under the Prime Minister's Department with the following objectives:

- i) to increase the number of entrepreneurs in the franchise sectors, and
- ii) to develop home grown products and services into franchise businesses.

According to Aziz (2003), The Malaysia Franchise Association (MFA) was formed in 1994 to support the implementation of the government program and also to promote entrepreneurship through franchising. In addition, the establishment of the MFA helped the government to serve as a resource center for both current and prospective franchisors, franchisees, media and the public. Membership to the MFA is open to any franchisors, franchisees, master franchisees, government agencies, banks, accounting firms, franchise consultants, attorneys, suppliers and vendors of franchises. The main functions of the MFA are as follows:

- i. Set and enforce standards of ethical business amongst members,
- ii. Act as a registry for information pertaining to franchise businesses operating, or intending to operate, within the country,
- iii. Coordinate and offer educational programs, seminars and exhibitions specially oriented to franchising matters,

- iv. Undertake promotional activities to promote franchising as a successful marketing business concept,
- v. Provide input and liaise with government departments and / or agencies on matters concerning franchising and its application,
- vi. Serve as a forum for exchange of experiences and expertise amongst members,
- vii. Establish and maintain affiliations with counterpart organizations globally,
- viii. Develop and maintain affiliations with local industry trade organizations representing distributors, retailers and the service industry generally,
- ix. Sponsor franchise trade and investment missions to other countries, and
- x. Host international franchise trade and investment missions and assist in familiarizing them with the potential in Malaysia.

In 1995, the FDP was transferred to the Ministry of Entrepreneur and Cooperative Development (MeCD) which was closed in 1992 when the FDP was transferred to the Ministry of Domestic Trade, Cooperative and Consumerism (MDTCC). The FDP is now run by the Perbadanan Nasional Berhad (PNS), an agency under the MDTCC, responsible for the development of the local franchise industry. PNS has provided financial facilities and advisory services to franchisors and franchisees for the expansion of new outlets in Malaysian and overseas markets. Additionally, PNS has developed special programs to accommodate the franchisor's and franchisee's financial requirements such as: Franchisor Financial Scheme, Pre-Franchise Scheme, Executive Franchise Scheme, Franchisee Financial Scheme and Franchise Micro-Financing Scheme. Furthermore, the PNS has also established the Franchise



Academy in order to enhance professionalism among franchise players in the franchise industry. The Franchise Academy has collaboration with Malaysian Higher Education Institutions such as Universiti Utara Malaysia (UUM), Universiti Kebangsaan Malaysia (UKM), Universiti Putra Malaysia (UPM), and Universiti Teknologi Malaysia (UTM) to develop franchising modules and training to new franchisors and franchisees.

In order to protect the rights of franchisors and franchisees, the Franchise Act was introduced in 1998. Under the Franchise Act (1998), all franchisors operating their franchises in Malaysia are required to register with the Registrar of Franchise (ROF) in MDTCC. The purpose of this registration is to control and monitor the development of new franchise players, who are categorized as the franchisor, master franchisee, franchisee of foreign franchisor and franchise broker. In addition, under the Act, the franchise agreement is a compulsory document which indicates the provisions and details of the business arrangement and the rights and obligations of both parties. A prospective franchisee is given ten days before signing this franchise agreement. The details of franchise contracts are discussed in Chapter Two.

Under the 8<sup>th</sup> Malaysia Plan (2001-2005), franchising business has been identified as one of the growth areas for the structural change and upgrading of the distributive trade industry. The Malaysian government had allocated RM100 million to MECD to promote, market, train and finance the Franchise Development Program with the objective of establishing 1,000 franchisees and 50 new franchisors over a five-year period (Ishak, 2010). Government policy and support play important roles in developing a successful franchise system in Malaysia. The fruits of this government's initiative, is that several local home-grown franchisors such as

MarryBrown, Secret Recipe, Reliance, Smart Reader and Clara International have achieved sustainable profitability in operating franchise systems in Malaysia and international markets.

**Table 1-2 : The franchise industry in Malaysia (divided by sector)**

Franchise Sector	Franchisor	Percentage
Food and Beverage (F&B)	115	30.8%
Other business	59	15.8%
Clothing and Accessories	55	14.7%
Learning Centre and Nursery	43	11.5%
Services and Maintenance	42	11.3%
Health and Beauty Care	29	7.7%
Information Technology (IT), Communication and Electric	17	4.6%
Convenience Shop and Supermarket	13	3.5%
<b>TOTAL</b>	<b>373</b>	<b>100%</b>

Source: Adapted from Malaysia Franchise Association (MFA), 2009

Today, the franchising business is largely of the business format franchising, involving various industries from fast food restaurants to home care (Blair & Lafontaine, 2005; Inma, 2005). As tabulated in Table 1-2, the franchise industry in Malaysia is diverse, involving various sectors, with the food and beverage (F&B) sector being the largest contributor in franchising business, accounting for 30%. Other business sectors include accounting at 15.8%, clothing and accessories accounting for 14.7%, learning centers and nurseries accounting for 11.5%, and services and maintenance representing 11.3%. Smaller contributors include health and beauty, IT/communication/electric and convenience shop and supermarket.

These figures show that franchising business has grown steadily in several industries and is readily accepted by Malaysian entrepreneurs as a successful business model. In addition, the previous Secretary-General of the MEDC, Datuk Musa Muhamad, commented that Malaysia is already on the right track and is ready to adopt the franchise business system (Ibrahim, 2008).

The growth of franchising in Malaysia can be attributed to initiatives taken by the government agencies to promote and support franchise program/activities such as franchise training, workshops, conferences and exhibitions. The PNS, as an agency under the MDTCC, is the main government agency overseeing the development of the franchising industry. PNS was given the mandate to lead the Franchise Development Program (FDP) which was introduced in 1992 as part of the government's effort to develop the Malaysian franchise industry. Other agencies such as Majlis Amanah Rakyat (MARA), Malaysia External Trade Development Corporation (MATRADE), The Small and Medium Enterprise Corporation Malaysia (SME Corp. Malaysia), Perbadanan Usahawan Nasional Bhd (PUNB), Credit Guarantee Corporation Malaysia Berhad (CGC) and SME Bank also play important roles in supporting the franchise industry in Malaysia (Aziz, 1999). These agencies provide financial assistance and advisory services to franchisors/franchisees in order to expand their business either locally or globally.

According to statistics reported by the MDTCC as at July 2009, 381 franchise companies were registered with the Register of Franchise (ROF) and over 6,500 franchise outlets were estimated to be operating throughout Malaysia (Yusof, 2009). Some local home-grown franchising businesses were found to be successful and had expanded their franchise systems to international markets such as MarryBrown,

Secret Recipe, Smart Reader, Clara International, Daily Fresh Reliance, Royal Selangor, D'Tandoor, Nelson and 1901 Hotdog. The commitment of the Malaysian government to produce more local home-grown franchise players is explained through the budgetary allocation of franchisors/franchisees to be developed during 8<sup>th</sup> and 9<sup>th</sup> Malaysia Strategic Plans. The number of franchisors/franchisees to be achieved is tabulated in Table 1-3.

**Table 1-3: Franchise development program by Malaysian government**

Malaysia Plan	No of Franchisors	No of Franchisees
8 <sup>th</sup> Malaysia Plan (2001-2005)	50	1000
9 <sup>th</sup> Malaysia Plan (2006-2010)	50	1000

Source : Ishak (2010), p. 3

Overall, the success of the FDP in developing franchisors and franchisees is still debatable. Even though many programs and activities have been implemented since 1992, the numbers of successful franchisors and franchisees, especially “*bumiputera*”, is still low compared to the Ministry’s target. To date, there has been no figure reported by the Ministry regarding the achievement of franchisors and franchisees in Malaysia compared to target. Based on Table 1-4, the statistics show that there is a significant uptrend in the number of franchisors from 2008 to 2012; for example the number of local franchisors has increased by 74% from 2008 to 2012. Similiarly, the increased in foreign franchisor is for 57% for the same period.

**Table 1-4 : Number of franchisors for Year of 2008 and 2012**

Origin	No of Franchisors	No of Franchisors	% Increase
	2008	2012	
Local franchisor	243	423	74%
Foreign franchisor	123	193	57%
Total	366	616	68%

Source: MDTCC, (2012b), p.9

Table 1-5 shows that 94 companies are identified as “*bumiputra*” franchisors, which represents only 27% of the total 343 registered as franchise businesses. On the other hand, the 2009 data provided by the Registry of Franchise shows that the increase in number of franchise businesses is approximately 17% (Zainuddin, 2009). Indeed, the growth of the Malaysian franchise sector moved aggressively; there is no a failure case or data reported by ministry to provide the true picture of development of franchise business system. The failure of existing franchisors and franchisees are expected to be increased in franchise business and to date, no study was found to clarify the problem faced by the franchisor and franchisee from a Malaysian context. Therefore, this study will help academics, practitioners and government agencies to understand the factors that contribute to an effective franchising relationship from the Malaysian perspective.

**Table 1-5: Composition of Franchisors in Malaysia**

Categories of franchisor	No of franchisor	%
International franchisor	116	33.8%
Local franchisor ( <i>non-bumiputra</i> )	133	38.8%
Local franchisor ( <i>bumiputra</i> )	94	27.4%
<b>Total</b>	<b>343</b>	<b>100.0%</b>

Source: Ishak (2010), p.4

#### 1.4 Problem Statement

The franchising business in Malaysia is still in its infancy and franchise businesses in this country have contributed only 5-6% to the Gross Domestic Product (GDP), compared to Australia and the United States of America where the contribution ranges from 50% to 55% (Shahabudin, 2009). Such low contribution shows that the franchising industry is still in its developmental stages and is expected to grow by 10% in its contribution towards the Gross National Products (GNP) in the 11th Malaysia Plan (MDTCC, 2012a). In order to generate more successful franchise players, the PNS was set to play an important role in leading the development of the franchise industry in Malaysia, by providing financial and training assistance to existing and potential franchisors (conversion of business to franchise) such as the Budding Franchise, the Smart Partnership Franchise and the Franchise Mezzanine. In addition, PNS has also developed special programs for *bumiputera* entrepreneurs such as the Youth Franchise Scheme, the Executive Franchise Scheme, the Graduate Franchise Program and the Women's Franchise Program. Although the government has conducted several intensive programs and activities to encourage more franchisors/franchisees, the number of successful franchisors/franchisees is very small (Sulaiman, 2009). Moreover, the Executive Secretary of the Malaysian Muslim Consumer Association, Datuk Nadzim Johan, suggests that the franchise programs should be reviewed due to the high failure rate experienced by the franchising entrepreneurs (Metro, 2009). As such, this study seeks to investigate the predominant factors affecting successful franchising relationships and identify important elements that sustain long-term franchising relationships among franchisees.

In Malaysia, many franchisees have encountered problems in running their business and some franchisees have left the franchise system due to poor performance or termination by the franchisor. For example, 30 franchisees filed for bankruptcy when they had to close their operations and faced difficulties in repaying their loan installments to the PNS (Mohd Anwar & Patho Rohman, 2009). One ex-franchisee in the food and beverage sector claimed that many franchisees face difficulties in operating their franchise business and finally close their outlets after one or two years in operation (Mohd Anwar & Patho Rohman, 2009). Furthermore, they notify that they are in debt of between RM100,000 to RM450,000 as a result of unfair practices of franchisors. Since no proper studies have been conducted to identify the franchisee problem, this research will explore the strength of franchising relationships and examine the antecedents as well as the outcome of successful franchising relationships. Such studies could assist the government agencies and MFA to formulate new strategies in order to enhance existing franchising developmental programs for potential new entrepreneurs.

The survival prospects and the success of franchise business systems continue to be debated among academicians and practitioners. Stanworth, Purdy and Price (1997) assert that despite the franchising industry claims of strong growth and low failure rates, the reality appears to have been of generally modest growth and high failure rates. Bates (1995) and Shane (1998a) finds that 35% of franchise business systems fail compared to 28% of non-franchised businesses. The real growth of US franchising from 1975 to 1990 plunged drastically from 284.6% to 58.5% and the average annual growth rate declined from 9.4% to 3.1% (Stanworth et al., 1997). Shane (1998) also highlights that approximately three-quarters of all new franchise

systems fail within twelve years. He also mentions that the high failure rate of the new systems suggests that franchising is not an easy business in which to succeed. He further developed a good model to explain the survival of the new franchise system. Even though the franchise system is a tested and proven model, it does not guarantee an entrepreneur's success. Carney and Gedajlovic (1991) and Lafontaine and Kaufmann (1994) highlight that the high rate of failure of the new franchise systems suggests that the survival of a new franchise system over time is an important measure of performance. Thus, this study will look into franchise performance and behavior intention (loyalty) as key factors which have contributed to the success of franchise systems especially from the franchisees' perspective.

It is expected that the existing franchise companies will eventually fail in their franchise businesses and, to date, no proper study has been conducted to shed light on the problems faced by the franchisors and franchisees in the Malaysian context. Very limited studies on franchising systems have been completed in Malaysia (Mohd Ali, 2009). Furthermore, a recent study reports that franchise survival rates and profitability are much lower than previously thought when compared to independent businesses (Bates, 1995). The probability of survival in franchising is very important because each franchisor and franchisee has invested their resources (franchisor resources – concept, brand, standard operating procedures; franchisee - royalty fees, initial fees) in the franchise business model. Thus, this study is essential to enable the academics and the government agencies, in particular the PNS, to understand and establish an effective franchise management model for the Malaysian franchisees and franchisors.



Studies on franchisee-franchisor relationships from the franchise contract is very important (Rodríguez, Pere, & Gutierrez, 2005) and franchise has been identified as a prototype of relational exchange (Grünhagen & Dorsch, 2003). Peterson and Dant (1990) claim that there has been a lack of research on the franchisee motivations for entering into the relationship. Thus, this research will explore the underlying factors that contribute to quality relationships from the perspective of the franchisee. Based on their review of the literature, Monroy and Alzola (2005) report that there have not been many studies to examine the quality of relationship between franchise partners as a global construct. They also stressed that it is important to develop a scale for measuring the quality of the franchising relationship in order to assess the strength of those dyadic relationships and to explain not only the behavior of the network partners but also the franchise performance. Thus this study will focus on franchising relationship quality and how it can affect the firm's performance.

In the marketing literature, many research studies focus on service quality and relationship marketing, while research dealing with relationship quality is scarce (Athanasopoulou, 2009; Watson & Johnson, 2009). In the relationship quality studies, there is a lack of consensus on the dimensions of relational quality, though there is consensus that relationship quality is a higher order construct consisting of several distinct, but related dimensions (Skarmeas & Shabbir, 2011). Several researchers have conducted their studies and used different dimensions of RQ in different business-to-business settings. For example, Crosby et al. (1990) used trust and satisfaction; De Ruyter, Moorman and Lemmink (2001) used affective/calculative commitment and trust; Dwyer et al. (1987) cited satisfaction, trust and minimal opportunism; whereas Fynes and Mangan, (2008) suggested trust,

adaptation, communication and cooperation as important dimensions quality concept which is still under-explored and remains unclear (Hennig-Thurau, Langer, & Hansen, 2001; Hennig-Thurau, 2000; A. Wong & Sohal, 2006). This study will investigate the determinant factors towards RQ from the perspective of the franchising relationships.

There has also been concerns regarding the directional link between relationship quality with behavioral (customer loyalty) and performance outcomes. Several researches report that the relationship quality will affect organizational performance. For example, Brown and Dev (1997) suggest hotel competitive performance, Harmon and Griffiths (2008) propose behavioral outcomes and performance outcomes for RQ impacts, Lee (1999) studies the direction of RQ towards performance, satisfaction and commitment. Apart from the performance outcomes, Morgan and Hunt (1994) suggest that RQ contributes to variables of acquiescence, propensity to leave, cooperation, functional conflict and uncertainty. Thus, the conceptual/construct of RQ and the main outcomes of RQ are still unclear. Urgent research is needed to examine the main outcomes contributing to RQ constructs in the franchising context.

The relationship between the franchisor and franchisee is very fragile. Without proper control and monitoring, conflicts between them are unavoidable. Indeed, franchising systems usually expose problems related to accountability and control (Connell, 1997). The franchise relationship varies over a series of stages in their life cycles: it spans introduction, growth, maturity and decline (Frazer, 2001). Frazer (2001) highlights that franchisees normally rely heavily on their franchisor(s) at the initial stage of their business, and gradually, becoming independent, specifically at